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In the Supreme Court of the United States

OCTOBER TERM, 1997

FIRST JERSEY SECURITIES, INC. AND ROBERT E. BRENNAN, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR THE PETITIONERS

STEPHEN M. SHAPIRO
Counsel of Record for Petitioners
MAYER, BROWN & PLATT
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600

[Additional Counsel Listed Inside Cover Page]

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A. LEON HIGGINBOTHAM, JR.
RICHARD A. ROSEN
PAUL, WEISS, RIFKIND,
WHARTON & GARRISON
1285 Avenue of the Americas
New York, New York
10019-6064
(212) 373-3000

- and -

Of Counsel:
EUGENE GRESSMAN
Professor of Law
University of North Carolina
School of Law
Chapel Hill, North Carolina
27599-3380
(919) 962-3688

Attorneys for Petitioner
Robert E. Brennan

RONALD J. RICCIO
Dean and Professor of
Law
Seton Hall University
School of Law
Newark, New Jersey
07102-5210
(201) 642-8750

- and -

JOHN B. LIVELLI
ROBINSON, LAPIDUS
& LIVELLI
Two Penn Plaza East
Newark, New Jersey
07105-2237
(201) 690-5400

Attorneys for Petitioner
First Jersey Securities,
Inc.

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THE QUESTIONS PRESENTED HAVE EXCEPTIONAL IMPORTANCE TO THE ADMINISTRATION OF THE FEDERAL SECURITIES LAWS

The Commission's brief in opposition is more notable for what it fails to dispute than what it affirmatively argues. The SEC does not deny that the only provisions of the securities laws *which authorize government relief in court* are confined explicitly to forward-looking injunctive relief, and do not authorize disgorgement. Nor does the SEC deny that the securities laws are replete with other provisions stating in the most precise terms what remedies Congress intended to authorize to achieve "deterrence." The SEC unaccountably mischaracterizes this case as having "unique factual circumstances." Br. 8. Yet, it does not question our demonstration that the disgorgement remedy is the most commonplace remedy in the agency's arsenal today, and has yielded billion-dollar annual recoveries. Nor does it deny that the threat of potentially ruinous disgorgement orders — bounded only by the trial court's unfettered "discretion" — is sufficient to coerce brokers, securities professionals, and corporate issuers to enter into virtually any settlement the agency demands.

As stated by a former General Counsel of the Commission, the "ancillary relief" theory advanced in this case means, as a practical matter, that "the range of remedies available is seemingly unlimited."[1/] SEC Chairman Richard Breeden has declared that these implied powers should be used aggressively by the Commission's enforcement lawyers to ensure that securities defendants are left "naked, homeless, and without wheels."[2/] True to the Chairman's word, the petitioners in this case have been forced into bankruptcy by the disgorgement remedy, which requires petitioner Brennan to give up gains ("illicit" or not) which he never received,

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[1/] Steinberg & Ferrara, Securities Practice § 5:09 at 24-25 (1992).

[2/] Quoted in Eisenberg, *Enforcement Issues and Litigation*, 21 Sec. Reg. L. J. 421 (1993).

pursuant to statutes which do not authorize such a radical judicial sanction.

As discussed in greater detail below, the Commission's defense of disgorgement rests on a patent misreading of this Court's precedents in cases like *Porter* and *DeMario*. Those decisions repeatedly state that judicially-implied remedies may not be engrafted on top of enforcement provisions that are expressly set forth in comprehensive enactments such as the federal securities laws. As this Court has stressed in its recent relevant decisions: "it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it." *Transamerica,* 444 U.S. at 19.

In an effort to bypass these precedents of this Court, the Commission falls back on the familiar refrain that Congress has "ratified" the SEC's interpretation through subsequent legislative history and later statutory enactments. In so arguing, however, the SEC does not even mention this Court's directly relevant decisions, including *SEC* v. *Sloan*, which rejected identical ratification arguments (436 U.S. at 119-122), and which made clear that when the Commission demands "awesome power with a potentially devastating impact" (*id.* at 112) that is "extremely far reaching" (*id.* at 121), a "clear mandate from Congress" is "necessary to confer this power" (*id.* at 112, 122). The subsequent statutory enactments cited by the SEC (Br. 13-17) address collateral issues unrelated to those presented here, and do not, by any stretch of the imagination, constitute a "clear mandate from Congress" authorizing such potentially devastating disgorgement orders.

Given the lack of statutory support for this $75 million sanction and the undisputed fact that petitioners have long ago settled or adjudicated *all* customer claims (Pet. App. 230a-245a), the Commission accomplishes nothing by rhetorically denouncing the "enormity of Brennan's wrongdoing." Br. 23. In condemning the amount of the "markups" charged by First Jersey, the courts below were required to make new law on a

retroactive basis and to resolve against petitioners a host of highly subjective issues, as shown by the opinions below. See Pet. App. 27a-32a, 70a-78a (the markup issue is "determined differently depending upon a number of factors," all highly fact-specific in nature). Petitioners offered detailed evidence at trial, including the testimony of the SEC's former chief economist, showing that the markups were justified under past industry and regulatory practice. Nevertheless, in a radical departure from its own precedents, the Commission attacked petitioners' markups by comparison to retail prices, ignoring wholesale prices previously relied upon; compared the prices of securities that were liquid and illiquid as if they were fungible products; and applied a newly-minted "unit cost" allocation formula which the district court acknowledged "has not received prior judicial imprimatur." *Id.* at 78a n. 23.

These are the very circumstances which have caused this Court to insist on a restrained interpretation of the agency's enforcement powers. *Dirks*, 463 U.S. at 664 n. 24 ("Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain"); Karmel, *Regulation by Prosecution*, 201 ("The potential for abuse is great when a government prosecutor is not held to the limitations and standards of a specified statutory remedy").[3/]

As in the many past cases cited in our petition where this Court rejected erroneous legal interpretations proffered by the SEC (Pet. 8), a grant of certiorari is urgently called for to bring the Commission's enforcement powers into harmony with the plain language of the securities laws and to reconcile prior lower court rulings with this Court's precedents. The

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[3/] See Cox, Hillman & Langevoort, *Securities Regulation*, 26 (1991) ("the Commission jealously seems to preserve the largest degree of discretion to sanction conduct that it determines, after the fact, to have been improper"); Winter, *Raising the Cost of Capital in America*, 42 Duke L. J. 945, 963-964 (1993) (the present "relentless drive" to "increase the discretionary power" of prosecutors and regulators of capital markets "moves in entirely the wrong direction").

extraordinary practical importance of this case to all market participants cannot seriously be disputed. Nor can the Commission seriously contest the need for establishing standards for the exercise of discretion which, in this case, has forced petitioner Brennan to disgorge "ill gotten gains" he never received, to surrender entirely lawful proceeds, and to pay more than $50,000,000 in interest on these phantom profits.

THE DISGORGEMENT ORDER CONFLICTS WITH THIS COURT'S PRECEDENTS

1. We admire the Commission's courage, if not its prudence, in arguing (Br. 12) that this Court's decisions in *Redington*, *Central Bank*, and *Transamerica* are simply "irrelevant" here. Unlike the cases which the Commission cites (Br. 9-10), these cases are squarely applicable because they interpret the provisions of the federal securities laws and arise in the modern era of statutory interpretation. Here, as in *Redington*, *Central Bank*, and *Transamerica*, the "existence" of a disgorgement remedy (Br. 12) could only have been divined by judicial implication. But these cases make clear that it is not the role of the judiciary "to fill any *hiatus* Congress has left in this area." *Redington*, 442 U.S. at 579. It is an "elemental canon of statutory construction" that a "particular remedy" fashioned by Congress "includes the negative of any other mode." *Transamerica*, 444 U.S. at 19-20.

It is equally fruitless for the Commission to invoke the "historic scope of a court's injunctive authority" (Br. 9, 12). By combining the unauthorized remedy of disgorgement with "joint and several" or "control person" liability — thereby forcing petitioner Brennan to disgorge "ill gotten profits" he never received for the benefit of persons who were owed no debt — the Commission has obtained a remedy without historical pedigree. In contrast to the simple reimbursement ordered in *Porter* and *DeMario*, the Commission's punitive remedy here is unprecedented and contrary to this Court's decisions declaring that Congress intended the injunctive provisions of the securities laws to be applied with "mercy

and practicality," "not to punish." *Rondeau* v. *Mosinee Paper Corp.*, 422 U.S. 49, 60-65 (1975); *Aaron* v. *SEC*, 446 U.S. at 701, 703 (equity balances "the public interest and private needs"; even a prospective injunction, without disgorgement, "is a drastic remedy, not a mild prophylactic").

Beyond this, the cases cited by the SEC (Br. 9-10) only serve to confirm that the disgorgement order here is in conflict with this Court's precedents. Like *Porter* and *DeMario* (see Pet. 21-22 n. 18), they repeatedly reaffirm that "[s]tatutory rights and obligations are established by Congress, and it is entirely appropriate for Congress, in creating these rights and obligations, to determine in addition who may enforce them and in what manner." *Davis*, 442 U.S. at 241. Thus, courts are permitted to imply remedies only "when Congress has given no indication of its purpose with respect to remedies," not where, as here, it has "expressly enumerated the remedies available." *Franklin*, 503 U.S. at 68-69 & n. 6.

Stated otherwise, "where a statute creates a right and provides a special remedy, that remedy is exclusive"; courts must defer to Congress when it has "selected the precise machinery and fashioned the tool which it deemed suited to that end." *Bannercraft Clothing*, 415 U.S. at 18. And while judicial implication of a remedy may be proper where Congress intended to afford a particular remedy without providing "clear indications" of the details of the available relief (*Musick, Peeler*, 508 U.S. at 293), such law-making is completely beyond the judicial function where, as here, Congress has already "meticulously detailed the remedies available" (*Mills*, 396 U.S. at 391). The disgorgement order sustained by the Second Circuit clashes fatally with these basic principles because Sections 20(b) and 21(d) of the 1933 and 1934 Acts expressly provide for the exclusive remedy of injunctive relief.[4/]

[4/] The SEC nowhere comes to grips with the plain language of Sections 20(b) and 21(d). Unlike the Emergency Price Control Act considered in *Porter*, 328 U.S. at 399, which authorized an injunction "or other

(continued...)

2. Relying once again on decisions of this Court addressing unrelated statutes (Br. 12, 14-15), the Commission claims that subsequent statutory enactments (relating to other subjects) and subsequent legislative history serve to ratify its expansive interpretation of Sections 20(b) and 21(d) of the 1933 and 1934 Acts. The agency makes this argument without disclosing that this Court has rejected such contentions in virtually every case in which the SEC has made them. Most recently, this Court held in *Central Bank*, 511 U.S. at 185-188, 192, that even where Congress "has amended the securities laws" with full knowledge of an SEC interpretation approved "[i]n *hundreds* of judicial and administrative proceedings in every Circuit in the federal system," "it does not follow that Congress' failure to overturn a statutory precedent is reason for this Court to adhere to it," since it is "impossible to assert with any degree of assurance" that there is "affirmative congressional approval" of the agency's view.

Before *Central Bank*, in a long line of decisions this Court repeatedly rejected SEC ratification arguments based on subsequent statutory amendments and legislative history. See *Sloan*, 436 U.S. at 112, 119-123 (even where Congress reenacts the securities laws with full knowledge of the SEC's interpretation, this does not constitute "approval" of "awesome" or "sweeping" remedies, which require "clear" and "unmistakable" authorization); *Aaron*, 446 U.S. at 694 n. 11 (securities law amendment, made with full knowledge of the SEC's views, "falls far short of providing a basis to support a construction" of the laws at odds with their "plain meaning"); *Transamerica*, 444 U.S. at 23 n. 13 ("subsequent legislation can disclose little or nothing of the intent of

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[4/](...continued)
order," Sections 20(b) and 21(d) authorize only a forward-looking "injunction or restraining order" to halt specific "acts or practices" that violate these statutes. It is hard to envision language less suggestive of the open-ended disgorgement remedy demanded by the SEC. Other provisions of these laws deal precisely (and subject to safeguards) with investor compensation and imposition of fines and penalties. Pet. 14-15.

Congress in enacting earlier laws"); *Dunn*, 117 S. Ct. at 920 (a subsequent amendment, made with knowledge of the agency interpretation, "sheds no light on the intent of the authors" of the original law); *Redington*, 442 U.S. 575 n. 16 (subsequent enactments lack "relevance," since it is "our task * * * to discern the intent of Congress when it enacted § 17(a) in 1934").

These principles apply with special force here. First, the statutory provisions relied on by the SEC do not come close to "approving" or "ratifying" a disgorgement remedy in SEC injunctive actions. The 1988 Insider Trading Enforcement Act, 15 U.S.C. 78t-l(b)(2), provides simply that private damage recoveries must be "diminished" by amounts, "if any," obtained in a disgorgement proceeding. The 1995 Litigation Reform Act, 15 U.S.C. 78u(d)(4) (Supp. I 1996), merely recites that any disgorged funds "shall not be distributed as payment for attorneys' fees." As shown by their plain language, these laws address special abuses — double recoveries by plaintiffs and overreaching by lawyers seeking fees — without declaring that disgorgement (especially disgorgement without limitations or safeguards) is authorized in federal court proceedings. They plainly do not provide the kind of "clear mandate" which this Court required in *Sloan* to authorize such "awesome power with a potentially devastating impact."

Beyond this, this Court already has held that the Insider Trading Enforcement Act, "which became law more than 50 years after the original securities statutes, focuses upon a specific problem" and there is "no indication that the drafters * * * sought to extend that enhanced protection to other provisions of the 1934 Act." *Lampf*, 501 U.S. at 361. The statutory language "makes clear that the 100th Congress sought to alter the remedies available in insider trading cases, and *only* in insider trading cases." *Id.* at 362. Thus, as to both the 1988 and 1995 enactments, "the legislative consideration of those statutes was addressed principally to

matters other than that at issue here" and "falls far short" of legislative authorization of disgorgement in injunction cases. *Aaron*, 446 U.S. at 694 n. 11.

Finally, this Court repeatedly has held that even if the Congressional understanding of a statute's meaning is expressly stated in subsequent amendments, that opinion of the later Congress "does not command our obedience" and "does not control the issue," even though it conveys a "sense of what Congress * * * understood." *Mackey* v. *Lanier Collection Agency*, 486 U.S. 825, 839-840 & n. 15 (1988); accord, *R. J. Reynolds Co.* v. *Durham County*, 479 U.S. 130, 151-152 n.22 (1986) (subsequent enactments with a "narrow focus," which imply a particular interpretation of prior law, are "not persuasive as to Congressional purpose"). Those principles are dispositive here.

This is not a case like *Loving*, 116 S. Ct. at 1749-1750, where a group of laws, considered "together," "give clear authority" to the agency. Accord, *Schor*, 478 U.S. at 845-846 ("Congress explicitly affirmed the CFTC's authority"). To the contrary, the plain language of Sections 20(b) and 21(d) authorizes prospective injunctive relief, and nothing else. If Congress meant to expand these injunctive powers to include a highly draconian form of disgorgement — and to reject established equitable principles announced in cases like *Rondeau* — it knew how to do so and had every opportunity to do so over a period of many years. Courts should not distort the legislative compromise, or bypass the requirements of bicameralism and presentment, by "filling in" this highly controversial "hiatus," which Congress has never seen fit to do.[3/]

[3/] The above-cited authorities also make clear that the Commission's reliance on subsequent legislative history is completely misguided. As stated in *Central Bank*, 511 U.S. at 185, the interpretation "given by one Congress (or a committee or Member thereof) to an earlier statute is of little assistance in discerning the meaning of that statute."

THE DISGORGEMENT ORDER CLASHES WITH SETTLED LAW IN OTHER CIRCUITS

The completely standardless award of disgorgement in this case conflicts sharply with the law in other Circuits. The Commission does not dispute that petitioners paid over $12 million in settlement and obtained releases from all of their customers, thereby resolving all customer claims, including any investor rights under "the disgorgement claims" now pressed by the SEC. Pet. App. 240a. The Commission also does not dispute that the amount of money received by petitioner Brennan from the challenged securities transactions was only $906,672. *Id.* at 228a. Yet incredibly it asserts (Br. 19) that there is "no basis for believing that this case would have been resolved differently in any other circuit."

The cases cited in our petition (at 23) make clear that several other Circuits would forbid any disgorgement order — such as the $75 million order here — that exceeds the amount actually earned by the defendant through alleged illegal acts. See also *Hateley* v. *SEC*, 8 F.3d 653, 655-656 (9th Cir. 1993) (a defendant found jointly and severally liable could not be charged for profits received by a co-defendant; "it was error to base disgorgement upon the total amount of commissions that were generated * * * instead of upon the amount of commissions that Cambridge actually retained"); *Nelson* v. *Serwold*, 687 F.2d 278, 281 (9th Cir. 1982) (defendant "should not be made to disgorge the profit from the sale of the stock owned by other members of the control group because [he] did not benefit from that profit"); *SEC* v. *MacDonald*, 699 F.2d 47, 54-55 (lst Cir. 1983) (en banc) (disgorgement extends only to profits from "wrongdoing," not other sources; "[a]ny further sum would constitute a penalty assessment").

The SEC nonetheless argues (Br. 19-20) that even though "Brennan received less than $1 million from his illegal conduct," he actually owes $75 million because he obtained unrelated "compensation" from First Jersey, had other money "available," and "benefitted" generally from the operations of the brokerage firm. None of this has the slightest relevance. As the SEC's authorities repeatedly state, disgorgement

reaches only "ill-gotten gains" (*SEC* v. *First City Financial*, 890 F.2d 1215, 1231(D.C. Cir. 1989)), not money that might have been (but was not) received, and not money gotten years later from unrelated business operations and transactions that never were proven to be unlawful. The SEC "must distinguish between legally and illegally obtained profits." *Ibid.*

The Commission's refusal to draw that basic distinction confirms the radical nature of its disgorgement theory and the need for this Court's review. If the SEC's approach were valid, *any* profit earned from a securities law violation would be sufficient to taint the future operations and earnings of a brokerage firm or other securities defendant — resulting in personal liability for disgorgement "in an indeterminate amount" and for "an indeterminate time." *Hochfelder*, 425 U.S. at 215 n. 33.

Whether traditional legal limitations apply to SEC disgorgement orders, as opposed to open-ended concepts of discretion, is a question that vitally affects a large number of litigated and settled cases every year, and which will continue to cause uncertainty in the lower federal courts until reviewed by this Court. This Court should grant certiorari to resolve the conflict among the Circuits, and to make clear that the Commission may not obtain billion-dollar annual recoveries in federal court in the absence of statutory authorization and on grounds that are purely subjective, standardless, and unreviewable.[9]

Respectfully submitted.

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[9] See *Central Bank*, 511 U.S. at 188-189 (criticizing "decisions made on an ad hoc basis, offering little predictive value," which cause businesses "to abandon substantial defenses" to "avoid the expense and risk of going to trial"); Dent, *Ancillary Relief*, 67 Minn. L.Rev. at 925 ("Effective appellate review is especially problematic in ancillary relief cases. * * * [T]he Supreme Court can review such cases only rarely. *To exercise any control at all, it must limit district court discretion*") (emphasis supplied).

STEPHEN M. SHAPIRO
Counsel of Record for Petitioners
MAYER, BROWN & PLATT
190 South LaSalle Street
Chicago, Illinois 60603
(312) 782-0600

A. LEON HIGGINBOTHAM, JR.
RICHARD A. ROSEN
PAUL, WEISS, RIFKIND,
WHARTON & GARRISON
1285 Avenue of the America
New York, New York
10019-6064
(212) 373-3000

- and -

Of Counsel:
EUGENE GRESSMAN
Professor of Law
University of North Carolina
School of Law
Chapel Hill, North Carolina
27599-3380
(919) 962-3688

Attorneys for Petitioner
Robert E. Brennan

RONALD J. RICCIO
Dean and Professor of
Law
Seton Hall University
School of Law
Newark, New Jersey
07102-5210
(201) 642-8750

- and -

JOHN B. LIVELLI
ROBINSON, LAPIDUS
& LIVELLI
Two Penn Plaza East
Newark, New Jersey
07105-2237
(201) 690-5400

Attorneys for Petitioner
First Jersey Securities,
Inc.